PART II. THE CRISIS OF 1931 AND SUBSEQUENT DEVELOPMENTS

INTRODUCTION

The economic system built up by the Baltic States during the period which ended in 1930 was highly sensitive to tendencies in the outside world. In other words, the system depended very largely on the maintenance of prices at or around the levels of the years 1925–30, and still more on the ability of the chief markets to continue to absorb Baltic exports. The system also presupposed that foreign capital would be available to finance foreign trade and, eventually, the larger schemes of development for which money was lacking at home. 433

The crisis of 1931 swept away these assumptions. There was first a catastrophic fall in the price of all the commodities produced by these States. Simultaneously the principal markets, the United Kingdom and Germany, began to restrict their imports from the Baltic countries. The result was a considerable fall both in the exchange available for imports and in the exchange reserves held by the Central Banks. This led, in turn, to the imposition of exchange restrictions and, in Estonia and eventually in Latvia, to the abandonment of the currency parities introduced after the War. Meanwhile, in order to save foreign exchange, imports had to be reduced to a small fraction of the figures attained before the crisis, with a consequently severe effect on the whole productive system. Finally, budgets were thrown into deficit and there was a general increase in public internal indebtedness. 458 439 457 [452]

During the years which followed 1931 the Baltic States have been adjusting themselves, gradually, and on the whole with a considerable degree of success, to the new conditions which have since prevailed. The process of adjustment has been immensely assisted by the fact that, unlike most of the States of Central and Eastern Europe, the Baltic countries did not accumulate an excessive amount of foreign indebtedness in the years before the crisis. On the contrary, one of the chief differences between the effect of the crisis in the Baltic and that in the Balkans, for example, is that none of the Baltic States has defaulted on its foreign debt.

For countries as small as the Baltic States, a policy directed towards the greatest possible isolation from the outside world—such as that pursued by Italy or Germany—was obviously out of the question. Nevertheless, the adjustment has been accompanied by a complete reorganization of the productive system. Estonia and Latvia, in order to economize exchange, have increased their production of cereals, which, as a general rule, they now no longer import. Latvia 433

working for export, especially the timber and plywood industries. This was followed by a general decrease of activity throughout the industries supplying the home trade, such as the textile industry, owing to the fall in agricultural purchasing power arising out of the decrease of exports. This movement was further accelerated by the credit crisis of 1931 and the moratorium on banking withdrawals; and by 1932 the monthly average total of unemployed was well over 14,000.[1]

Meanwhile, in the autumn of 1931 there was a general increase in Customs duties, and a system of import quotas and exchange restrictions was introduced. All these measures greatly increased the tendency towards industrial self-sufficiency, which now became the acknowledged policy of the Government. There was consequently a considerable increase in the activity of the consumption industries, especially the textile sections, which, as in Estonia, increased their consumption of home-grown flax. This led in turn to an increase of activity in the production goods industries. At this stage the export industries began to experience a recovery, and by the end of 1934 the building boom in the United Kingdom began to have an appreciable effect on the plywood industry and saw-mills. There was also a marked recovery in the paper and cellulose industry.

Up to this point industrial expansion had followed the normal course of recovery from a severe recession. This recovery had taken place for the most part within the limits of the existing industrial apparatus. Few fresh industries had been started, and the relations existing between industry and the State before 1930 had, for the most part, been maintained. The advent of the totalitarian system in 1934, however, has been followed by an entirely new industrial policy. This policy does not consist merely in an attempt to attain the greatest degree of self-sufficiency. Its purpose would seem rather to be the introduction of a form of State capitalism or, at any rate, a system in which the State is able to exert direct control over the industrial organization. It will be seen how the State, by its relation to the co-operative system, is able to exert a considerable degree of control over agriculture and dairy farming. This, however, is a policy which the State is generally compelled to pursue in a poor country of small farmers. That such a policy should be applied to a relatively large industrial organization, which had hitherto relied on private enterprise, was a considerable innovation.

The policy began to be put into effect first through the *Latvijas Kreditbanka*,[2] a commercial bank formed by the State in 1935. By the purchase of majority shareholdings, this organization soon

[1] i.e. demands for work according to the official returns.

[2] On this, see further pp. 164–5.

1: Anonymous U-4 (no date)1938 RB1 Baltic States RB2
Estonia

III. THE FINANCIAL SITUATION

1. The Exchanges and Monetary Policy, 1931–7

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The general principle upon which currency stabilization had been effected in the Baltic States was, briefly, that central banks should hold gold or foreign exchange reserves sufficient to offset any temporary adverse movements in the balance of payments which could not be covered by capital imports. These reserves were naturally not large enough to meet withdrawals of foreign capital on a large scale; and it cannot be said that they were intended to be. By the end of 1930 it had become impossible to import capital owing to conditions on foreign money markets. Moreover, the reduction of foreign trade was leading, as has been seen, to serious deficits in the balance of payments. The German crisis, which began in July 1931, was followed in the Baltic States by an entire loss of confidence, and to some extent by a withdrawal of German and other foreign capital, leading quickly to a considerable amount of domestic withdrawals. Finally, the collapse of sterling in September of that year led to conditions bordering on panic, for in Estonia, and to a smaller degree Latvia, the foreign exchange reserves of the Central Banks had been held largely in sterling, and to that extent were reduced proportionately with the fall of the pound.

All these events struck at the very principle upon which the Baltic currencies had been stabilized, but the policy adopted to meet them has varied considerably from country to country. In Estonia and Latvia official exchange restrictions were adopted in the autumn of 1931; but Lithuania was able to avoid this step until 1935. Again, Estonia decided to abandon the gold standard and join the sterling *bloc* in the summer of 1933, but Latvia did not follow her example until September 1936, while in Lithuania the external value of the currency has been maintained at the same level ever since the stabilization of 1922. Lastly, the general improvement in world economic conditions since 1933 has been reflected very differently in the currency systems of these three States. It will therefore be necessary to examine the position in each country separately.

Estonia. In Estonia exports had tended to decrease since 1928, but imports had been reduced, and there was a comfortable surplus of merchandise exports in 1931. Invisible exports also exceeded invisible imports in that year. It might therefore be asked why a currency crisis should have arisen at all. The answer would be that it was largely a crisis of confidence. The German catastrophe of July 1931 had been followed by withdrawals of German capital, and a flight from the kroon by Estonian nationals. Moreover, a large proportion of the *Eesti Pank*'s foreign exchange reserves consisted of

452 sterling, and the loss on the abandonment of the gold standard by Great Britain was considerable. Even before 1931 these reserves had 457 been allowed to fall to a low level, and it was clear that, if sterling 458 continued to depreciate, they would soon fall below the minimum required for safety.

At this stage the alternatives before Estonia were to abandon the gold standard like the Scandinavian countries—the kroon, it will be remembered, was based on the Swedish crown—or to impose a system of exchange control. Estonia, however, had not sufficient resources to justify taking the chances with her currency which the former alternative seemed to involve, especially in the uncertainties prevailing during the autumn of 1931. Moreover, the abandonment of the gold standard, it was felt at the time, might lead to currency inflation, the disastrous effects of which Estonia had already experienced once. It is not surprising, therefore, in the circumstances, that unofficial exchange restrictions were introduced early in October, though official control of the exchanges was not put into effect until November 19, 1931. The restrictions were constantly made more rigid throughout the year that followed. With their help, and that of the increased restrictions on exports, the gold value of the currency was maintained at its legal level.

It gradually became clear, however, that this was a somewhat empty achievement. The example of Germany was beginning to show the difficulties to which exchange control leads. Moreover, maintenance of the original value of the kroon penalized Estonia's exports to Great Britain, and placed her in a poor position to compete with other exporters of dairy produce and timber in countries which had depreciated their currencies. It was gradually recognized, therefore, that a mistake had been made. In December 1932 it was decided to impose an *ad valorem* tax of 15 per cent. on sales of foreign exchange to importers, &c., the proceeds of which were allocated to a fund established for subsidizing exports. The depreciation of the dollar in March 1933 considerably lightened the burden of Estonia's foreign debt, and it thus became possible to go even farther. On June 28, 1933, the gold standard was abandoned, and the external value of the kroon was reduced to that of the Swedish crown, involving a depreciation, at that stage, of about 35 per cent. Finally, during the following autumn it was decided to base the external value of the Estonian kroon directly on that of sterling, with which currency the kroon has since fluctuated.[1]

[1] According to the League of Nations *Memorandum on Commercial Banks, 1935–6*, Geneva, 1936, p. 74, the gold held by the *Eesti Pank* at the time of the abandonment of the gold standard, viz. 19 million kroon, has not yet been revalued. A substantial profit should eventually accrue to the State therefrom.

1: Anonymous U-4 (no date)1938 RB1 Baltic States RB1
Estonia
Latvia

There is little doubt that the general improvement which followed was due to the abandonment of the gold standard. Wholesale prices began to rise appreciably enough to give some relief to producers, but not sufficiently to offset the effect of currency depreciation on foreign trade, for the value and volume of exports, especially to the United Kingdom, began to increase almost immediately. Lastly, as will be seen from the table at the end of this section, the exchange reserves also began to improve, and it was possible to relax the exchange restrictions considerably. It is true that restrictions are still in force, but their main purpose is to prevent the export of capital and the import of goods not considered to be essential to Estonia's economy; and they do not at present interfere very greatly with normal commercial transactions.

Latvia. In Latvia the decrease of foreign trade between 1929 and 1931 was very considerable, but the current items of the balance of international payments showed a surplus both for 1930 and 1931. As in Estonia, the extraordinarily severe financial crisis of the latter year was largely a crisis of confidence. The withdrawals of capital arising out of the German banking crisis of July were even heavier in Latvia than they were in Estonia, and there was an alarming decrease in the gold and foreign exchange reserves of the Central Bank. The amount of withdrawals, both foreign and domestic, was so large that regulations were introduced in the middle of July 1931 imposing strict limits on the proportion of deposits which might be withdrawn.[1] These difficulties were greatly increased by the abandonment of the gold standard in the United Kingdom, much of Latvia's exchange reserves being in sterling, and on October 8, 1931, a system of exchange control was introduced.

Although the banking moratorium was gradually relaxed, the severity of the exchange restrictions was constantly increased, and their scope was considerably widened. This process continued until 1935, and though, as will be seen, the currency was virtually allowed to depreciate in that year, the nominal gold parity was maintained up to September 1936. Since the economic structure of Latvia so closely resembles that of Estonia, which had abandoned the gold standard in June 1933 and greatly profited thereby, the question will arise why Latvia did not follow Estonia's example. It should, however, be pointed out that Latvia had experienced a severe credit crisis, whereas Estonia had not; and that this greatly intensified the common fear that the abandonment of the gold standard might be followed by a currency inflation similar to that of the period immediately after the War. Moreover, before the crisis, Latvia, unlike Estonia, had an habitual surplus of merchandise

[1] On the banking moratorium in Latvia, see further pp. 184–5.

451 652 458 imports, and it was felt, not without some justification, that until this import surplus had been converted into an export surplus, or at any rate substantially reduced, experiments with the currency would be inadvisable.

Whatever the reasons for Latvia's choice, its effects are plain. The Government was gradually led by the consequent deflation to extend the control which it now exerted over exchange movements, not only to almost every branch of production and trade, but to the credit system as well,[1] and to follow an economic policy very similar to that pursued by Germany for the same reasons. But it was clear that, though this system enabled the Government to maintain that the nominal gold parity of the lat was unaltered, it did nothing to improve foreign trade, and Latvian exports to Great Britain met with considerable competition from Estonia. The Latvian exchange policy was, consequently, modified so as to assist exports. The change took the form at first of a direct subsidy to exporters of the principal export commodities, such as butter. During 1935, however, a new system was introduced whereby the exporter received a premium in lats over the official price given by the control authorities for the exchange produced by his exports, and the importer had to pay a similar premium for the exchange required to pay for his imports. This premium at times rose to as high a figure as 35 per cent. In other words, the Government were virtually forced to admit that the external value of the currency had depreciated by roughly 25 per cent.

Nevertheless, although this admission was of some value to Latvia's foreign trade, the system introduced in 1931 was maintained until the end of September 1936. The almost simultaneous devaluation of the French and Swiss francs and the depreciation of the Dutch guilder gave the Latvian Government the opportunity of openly recognizing the depreciation in the external value of the lat without losing prestige.[2] On September 28 a law was passed fixing the parity of the lat at 25·2215 to the £, the parity existing before Great Britain abandoned the gold standard.[3] Since sterling has no fixed value in gold, this step on Latvia's part was equivalent to the abandonment of the gold standard; and from that date the lat has belonged, like

[1] On this point see further, p. 185.

[2] The difficulty of adhering to the currency policy which Latvia had chosen was shown shortly before the devaluations of September 1936 gave her this opportunity. In July 1936 it had become necessary for the Government to reduce the gold and foreign exchange cover for the note circulation from 50 per cent. to 30 per cent. of the total note issue, provided that the latter was less than 100 million lats. *Frankfurter Zeitung*, July 16, 1936.

[3] An exchange equalization fund was established in November 1936, to which was allocated some of the profit arising out of the writing up of the value of gold in the hands of the Government and the *Latvijas Banka*. Exactly how much of the profit was so used is not known.

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Lithuania

the Estonian kroon, to the sterling *bloc*. The exchange restrictions, however, have not been notably relaxed, and it is still necessary for Latvian importers to obtain an import licence, which usually carries with it a permit to receive exchange, though in practice the restrictions now interfere little with normal commercial transactions. 457 652 458 ●

Lithuania. In Lithuania the immediate effects of the general financial crisis of 1931 were less severe than in the other two countries. The extent of foreign investment in the banking system was smaller, and the withdrawals which took place were not sufficient to lead to any great loss of confidence in the currency. Moreover, the loss on the abandonment of the gold standard in Great Britain was not so large as in Estonia or Latvia, for the gold reserves of the Central Bank were chiefly held in dollars and not in sterling. Thus, although the fall in the volume of foreign trade had been considerable, and there were some domestic withdrawals from the banks, there was no serious flight of capital. Large exports of capital did not, in fact, begin to take place until 1935, and it is significant that, though the current items of the balance of payments had led to an unfavourable balance in 1931 and 1932, and there was a corresponding decrease in the gold and foreign exchange holdings of the *Lietuvos Bankas*, official exchange restrictions were not introduced until October 1935. The inference must be, it would seem, that the reserves accumulated year by year up to 1930 were sufficient to offset current adverse movements, but not to cover a heavy export of capital.

The sudden deterioration of the position in 1935 was largely due [648] to extraordinary causes. The dispute with Germany over Memel, as has been seen, led to an almost complete suspension of commercial intercourse with what had been Lithuania's best customer. Moreover, the increase of emigration to Palestine was responsible for capital withdrawals on a fairly considerable scale. Thus, though the Central Bank had avoided a loss on the devaluation of the United States dollar in 1933 by converting most of its dollar holdings into gold or other currencies before the dollar was devalued, its gold and foreign exchange reserves continued to decrease. By the end of September 1935 the margin above the 33⅓ per cent. required as cover for the note issue was negligible, and on October 1 exchange restrictions were at last introduced. With their help the original gold parity of the litas has since been maintained.

It will be asked how this has been possible during a time in which Lithuania's chief competitors in the export market had the advantage of a depreciated currency. The reply seems to be that in Lithuania the fall of prices was greater than in the other two countries, and that,

457 652 458 so far as exports are concerned, this offset some of the advantages gained by Estonia and Latvia through currency manipulation. Moreover, most exports have gradually been brought under the control of Government agencies, direct or indirect, and in some cases, e.g. butter, considerable subsidies have been granted. Lastly, the standard of living is considerably lower in Lithuania than in the other two countries, and in Lithuania the peasant is perhaps readier than in Estonia or Latvia to accept the lower prices which he must ask if his goods are to compete in world markets. But, though Lithuania has thus been able to make the best of both worlds by retaining her share of the foreign market, and at the same time adhering to the gold standard at the old level, the situation is clearly artificial, and the fact that it is necessary to subsidize exports indicates that the claim that the old parity of the litas has been maintained is not strictly correct. It is therefore surprising that Lithuania did not, like Latvia, seize the opportunity to recognize the *fait accompli* in September 1936. But, both then and since, the Government has insisted that there will be no change in their currency policy, and meanwhile the restrictions have been maintained. No difficulties, however, have been made by the authorities up to the present in supplying foreign currency for legitimate commercial transactions.

Developments during the period can be seen from the table opposite.

2. Public Finance

652 The budgetary position of all three States was, of course, severely affected by the crisis. The fall of agricultural prices rendered the collection of taxes difficult, and the general decrease in activity led also to a decrease in the revenue from indirect taxation, particularly from import duties. Ordinary expenditure, on the other hand, could not always be reduced *pari passu* with revenue, and, though very considerable economies were made, budgets were thrown into deficit. At the same time, though extraordinary expenditure was greatly reduced by the suspension of expenditure on public works, the State was obliged to spend considerable sums, usually outside the budget, on assisting the economic system by subsidies and other similar measures. During the last year or two, however, the increase of activity has led to a considerable improvement in ordinary budgets. But with this improvement there has been no reduction of the direct interest which the State had taken during the crisis in various branches of economic activity. On the contrary, the direct part thus played by the State has considerably increased in importance, at any rate in Estonia and Latvia, though the relevant figures do not always appear in the budgets.

1: Anonymous U-4 (no date)1938 RB1 Baltic States RB1
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TABLE 51. *Position of the Exchanges*

	Exchange Reserves of Central Bank in millions (at end of year)			External value of currency expressed as a percentage of gold parity (average for year)
	Gold	Foreign Exchange	Total	
Estonia: (kr.)				
1929	6	21	27	99·8
1930	7	16	23	99·6
1931	7	15	22	99·8
1932	15	5	20	100·2
1933	20	2	22	82·4
1934	28	4	32	62·1
1935	34	2	36	60·1
1936	34	9	43	60·8
1937	34	17	51	60·4
*Latvia:** (lats)				
1929	24	56	80	99·9
1930	24	41	65	100·0
1931	32	15	47	99·9
1932	36	12	48	100·0
1933	45	3	48	99·2
1934	46	4	50	96·3
1935	46	7	53	98·7
1936	77†	28	105	89·6‡
1937	77†	43	120	60·0
Lithuania: (lits)				
1929	35	78	113	99·7
1930	39	86	125	100·1
1931	50	33	83	100·2
1932	49	16	65	100·3
1933	52	15	67	100·1
1934	52	8	60	100·0
1935	36	18	54	100·0
1936	73	10	83	99·7
1937	79	6	85	99·4

* Gold holdings include gold held by the Government.
† After revaluation on the abandonment of the gold standard.
‡ Until the end of September the old parity of the lat was maintained in theory.

Estonia. Developments in recent years are shown in Table 52 on p. 178.[1]

The decline in ordinary revenue from the figure reached in 1928–9 was offset by a considerable reduction in ordinary expenditure effected during 1932. In that year salaries of officials were reduced by from 4 to 26 per cent., and large savings were made on repairs, renewals, and the purchase of materials. In spite of these measures,

[1] Most of the figures in the following tables and the information in this section are taken from the League of Nations: *Memorandum on Public Finance, 1928–1935*, Geneva, 1936–7, to which reference should be made for fuller details. Figures for Estonia in 1935–8 are taken from an article by the Assistant Minister for Economic Affairs, M. A. Keller, in *The Banker* for March 1938.

1: Anonymous U-4 (no date)1938 RB1 Baltic States RB2

TABLE 55. *Gross Foreign Indebtedness* 457

(In million Swiss francs)

At end of:	Estonia			Latvia		Lithuania	
	1930	1935	1936	1930	1935	1930	1934
1. Intergovermental debt	114·0	67·5	67·6	85·1	52·7	36·2	22·6
2. Other Government and municipal debt . . .	51·7	23·3	26·9	31·1	29·5	37·7	28·0
3. Foreign long-term investments in banks, industry, &c.	45·8	23·3	22·1	104·6	82·9	33·6	43·6
4. Private short-term debt and other debt . . .	?	0·9	3·8	137·3	108·7	15·9	10·6
Total	(211·5)	115·0	120·6	358·3	273·6	123·4	104·8

The large reduction in intergovernmental debt is due to the depreciation of the dollar and sterling, which accounts also for much of the decrease in the other items, especially Government and municipal debt. The small decrease in Latvia's Government and municipal debt is due to the inclusion, in 1935, of the Riga debt already mentioned. It remains to be added that neither Estonia nor Latvia has had the full benefit of this decrease in their foreign indebtedness, owing to the depreciation of their respective currencies. Yet the amount of foreign debt is still relatively small, and so far as can be seen the service imposes no heavy burden on any of the three States.

4. THE BANKING SYSTEM, 1931–7

The crisis of 1931 had a severe effect upon the entire banking system. The commercial banks, which depended largely upon the financing of foreign trade, were the most seriously affected, owing to the general decrease of exports and imports, and especially to the exchange restrictions, which generally had the effect of centralizing dealings in foreign currency in the Central Banks or their nominees, while, as was seen, a large number of foreign credits made available to commercial banks in these countries by their foreign correspondents was withdrawn during 1930 and 1931. Mortgage banks, also, suffered severely through the decline in agricultural prices, which made it difficult, if not impossible, for peasants to meet the service of loans contracted when prices were considerably higher; and, as already noted, measures had to be taken to relieve such debtors in Estonia and Latvia. Finally, the general reduction in economic activity was inevitably reflected in the co-operative system, though the effect of the depression was less evident in this case than elsewhere. 453 458 652

The general recovery of the economic situation in all three countries has naturally been followed by an improvement in the position of

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the banking system, particularly in that of the commercial banks. In the latter case the recovery has been accompanied, in Latvia and Estonia, by developments which are of some interest, and which are noted below. For reasons of space it is impossible to describe the developments which have taken place during the last few years in the other branches of the banking system. This omission is not of great importance, since the co-operative system, for example, remains, in principle at any rate, what it was before the depression. However, the difficulties encountered by the commercial banks since 1930 have somewhat increased the part which it plays in financing the internal distribution and export of agricultural goods, and even in the import of agricultural machinery and artificial manure. A further development outside the realm of commercial banking is the increase, since 1931, of deposits with Government savings banks, perhaps as a consequence of the lack of confidence, at any rate until the last year or two, in the commercial banks. Finally, it should be said that no complete statistics are available in a comparable form to show developments in the banking system of the Baltic States as a whole. A table showing the movement of deposits since 1929 is given on page 187.

Latvia. The most remarkable developments in commercial banking have taken place in Latvia. In order to explain these developments it is necessary to begin with the crisis of 1931. The German banking crash in July of that year led to an almost complete collapse of Latvia's commercial banking system. German withdrawals of credit and deposits had been particularly severe, and in the first fortnight of that month two of the largest commercial banks, which had close relations with the German banking system, stopped payment. The prevailing uncertainty led to conditions bordering on panic in Latvia, and there was a large number of domestic withdrawals. It finally became necessary for the Government, on July 21, to authorize the banks to restrict withdrawals of deposits to 5 per cent. of the total deposits per week, a figure which was subsequently reduced to 2½ per cent. This regulation was kept in force until the latter part of 1932, and only one of the private banks did not take advantage of it, but continued to pay out deposits in full during the whole period. In this bank a considerable amount of British capital was invested.

But, though this measure checked the further progress of the credit crisis, it naturally did not promote the return of confidence in the commercial banking system. For two years, as can be seen from the table at the end of this section, deposits with the joint stock and municipal and mutual credit banks remained at approximately the level to which they had fallen by the end of 1931, i.e. about half

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that of the peak year, 1929. Meanwhile, the banks were not able to improve their position through any increase in economic activity, for such an increase was prevented by the monetary policy pursued by the Government, at any rate until 1935.[1]

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At this stage the State, now converted to totalitarian principles, intervened with a programme of reform. The instrument of this reform was the *Latvijas Kreditbanka*, founded by the Government in April 1935 with the comparatively large capital of 15 million lats.[2] The bank is directly controlled by the Ministry of Finance, and is empowered by decree to take over other banks or industrial concerns, at an arbitrary valuation from which there is no appeal, if the Minister of Finance is satisfied that they are in difficulties. This institution proceeded to put into effect a programme of compulsory amalgamation by taking over or liquidating a large number of commercial banks, in some of which a considerable amount of foreign capital was invested and, at the same time, to carry on ordinary banking business in competition with the few banks which remained. Thus, the bank began to acquire for itself a position in the financial system very similar to that of a monopoly.[3]

During 1936 and 1937 the importance of the *Latvijas Kreditbanka* has been still further extended. The bank has begun to take a direct shareholding interest in a number of important industrial concerns of a very varied nature, and thus to acquire a 'sphere of interest' in industry on behalf of the Government. While the Government has stopped short of the nationalization of all private interests, the powers possessed by the *Kreditbanka* are so large, and are exercised so arbitrarily, that considerable anxiety exists, not only in Latvia itself, but also abroad. Reassuring speeches, however, were made by the authorities during the first few months of 1937, which have done something to allay these feelings.[4]

Estonia. The effect of the crisis of 1931 on the commercial banks in Estonia was less severe than in Latvia, for, though the volume of credits withdrawn by foreign correspondents in 1931 was large, the connexion with the German banking system was perhaps less close. At all events, there was no collapse of the banking system similar to that which took place in Latvia, and drastic reconstructions were

[1] See above, pp. 173–4.

[2] This was increased to 20 million lats in 1936.

[3] A similar policy was adopted with regard to insurance in Latvia. A law was passed in October 1934 granting the State Insurance Department of the Ministry of Finance wide powers over private insurance companies, requiring them to pay 10 per cent. of their premiums to the Department, and requiring fire policies to be reinsured with the Department to the extent of 25 per cent. Foreign insurance companies and their agents were forbidden to operate in Latvia. See D.O.T.: *Economic Conditions in Latvia, January 1935*, publ. 1935, pp. 7–8.

[4] The effect of recent developments in Latvian banking is discussed in the *Economist* of March 14, 1936, and January 9, 1937.

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postponed until 1934, when one of the largest commercial banks was finally compelled to write down its capital by a substantial proportion. Similarly, the direct part played by the State in dealing with the banking system was very much smaller, though mention should be made of the introduction of a national credit law in March 1932, which supplemented the old Russian credit statutes hitherto in force.

The abandonment of the gold standard was followed by a considerable improvement in the banking position as a whole, and by 1935 most of the more important units of the system had completely recovered from the effects of the depression. The further growth of activity since 1935, and in particular the increase of industrialization, led to a considerable expansion of credit. Its extent may be judged from the fact that on December 1, 1937[1], the loans and discounts of 13 joint stock banks and the 25 principal co-operative banks stood at 97·2 mill. kr., as compared with 73·3 mill. kr. at the end of 1932. There was a similar movement also in the loans made by the Central Bank. This expansion created a serious problem for the Estonian credit system. For, since the middle of 1936, there had been a number of indications suggesting that economic activity had reached something like a boom level. In industry, as has been seen, there had actually been a shortage of labour, which had begun to attract workers from agriculture. The note circulation, also, had expanded —from 32·1 million kroon at the end of 1932 to 49·1 millions at the end of 1937—though there had also been an increase in the gold cover. But, as was shown, prices also had risen very rapidly. In these circumstances the continuous expansion of credit by the banking system aroused some apprehension, especially as there was a large import surplus both in 1936 and 1937. However, although by March 1938 no measures had been taken to restrict credit, there were signs that the authorities realized the dangers of the situation and were attempting to control the volume of capital outlay in building and industry.[2]

Lithuania. Developments in the commercial banking system in Lithuania were of less importance than in the other two countries. As already noted, the crisis of 1931 did not lead to a flight from the currency or to foreign withdrawals of capital on any great scale. There was, it is true, a number of domestic withdrawals in 1931, from which the commercial banks were just beginning to recover when the events of 1935 referred to above[3] took place. Even so, the

[1] Subsequent figures are not comparable.

[2] It is of interest, however, in this connexion that in the spring of 1938 a proposal was being discussed in the Estonian press, according to the *Revalsche Zeitung* of March 5, 1938, for increasing the capital of the *Eesti Pank*. Since then little more has been heard of the proposal.

[3] See p. 175.

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abnormal export of capital in that year was arranged without any really serious effect on the banks, and there were no important failures. Since 1935 there has been a steady improvement.

TABLE 56. *Movement of Deposits and Current Accounts with Commercial and Savings Banks*

(In millions of national currency)

At end of	I. Commercial Banks (deposits and current accounts)			II. Savings Banks (deposits only)		
	Estonia* (all commercial and principal co-operative banks)	Latvia (joint stock banks and mutual and municipal credit assocs.)	Lithuania (commercial banks and mutual credit assocs.)	Estonia (State savings bank)	Latvia (postal savings bank)	Lithuania* (State savings institution)
1929	65	92	96	3	4	2
1930	73	99	139	4	7	11
1931	60	49	140	5	8	25
1932	51	49	143	5	13	34
1933	51	51	149	6	20	39
1934	65	63	157	8	24	43
1935	74	74	155	10	49	43
1936	93	117	170	10	61	53
1937	103	173	204	10	79	60

* January 1 of following year.

IV. CONCLUSION

It has been seen that in Estonia and, superficially at any rate, in Latvia, currency manipulation has been followed by a considerable degree of recovery, while in Lithuania the position has substantially improved in the face of that country's refusal to follow their example. In spite of the fall of prices during the first half of 1938, all these countries were still enjoying a measure of prosperity greater than at any time since 1931. This recovery has been based, broadly speaking, on the gradual expansion of exports to the United Kingdom, the higher level of world prices as compared with that of the crisis years, and, so far as the internal position is concerned, on the policy of self-sufficiency dictated by the lack of foreign exchange in the years of the depression. It remains to examine how far these elements can be considered to be of a permanent nature.

It will first be seen that the case of Lithuania differs somewhat from that of the other two countries. In Lithuania the productive system has remained essentially very much what it was before the crisis of 1931. Provided, therefore, that there is no fundamental change in her economic policy, it is reasonable to suppose that Lithuania will continue to exchange agricultural produce for manufactured articles, and that the index of her prosperity will continue